
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2006

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File No.: 000-51826

MERCER INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Washington
*(State or other jurisdiction
of incorporation or organization)*

47-0956945
*(I.R.S. Employer
Identification No.)*

Suite 2840, 650 West Georgia Street, Vancouver, British Columbia, Canada, V6B 4N8
(Address of office)

(604) 684-1099
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the *Securities Exchange Act of 1934* during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

The Registrant had 33,179,140 shares of common stock outstanding as at August 8, 2006.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2006
(Unaudited)**

FORM 10-Q
QUARTERLY REPORT - PAGE 2

MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

As at June 30, 2006 and December 31, 2005
(Unaudited)
(Euros in thousands)

| | <u>June 30, 2006</u> | <u>December 31, 2005</u> |
|---|--------------------------|------------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | € 73,079 | € 83,547 |
| Cash restricted | 5,892 | 7,039 |
| Receivables | 87,020 | 74,315 |
| Inventories | 69,544 | 81,147 |
| Prepaid expenses and other | 6,240 | 5,474 |
| Total current assets | <u>241,775</u> | <u>251,522</u> |
| Long-Term Assets | | |
| Cash restricted | 66,537 | 24,573 |
| Property, plant and equipment | 1,008,319 | 1,024,662 |
| Investments | 7,695 | 6,314 |
| Deferred note issuance and other costs | 7,674 | 8,364 |
| Deferred income tax | 38,798 | 78,381 |
| Total assets | <u>€1,370,798</u> | <u>€1,393,816</u> |
| LIABILITIES | | |
| Current Liabilities | | |
| Accounts payable and accrued expenses | € 109,113 | € 112,726 |
| Debt, current portion | 75,375 | 27,601 |
| Total current liabilities | <u>184,488</u> | <u>140,327</u> |
| Long-Term Liabilities | | |
| Debt, less current portion | 898,379 | 922,619 |
| Unrealized foreign exchange rate derivative loss | 11,735 | 61,979 |
| Unrealized interest rate derivative losses | 42,320 | 78,646 |
| Pension and other post-retirement benefit obligations | 16,541 | 17,113 |
| Capital leases and other | 9,980 | 9,945 |
| Deferred income tax | 17,428 | 14,444 |
| Total liabilities | <u>1,180,871</u> | <u>1,245,073</u> |
| Minority Interest | — | — |
| SHAREHOLDERS' EQUITY | | |
| Common shares | 181,655 | 181,586 |
| Additional paid-in capital, stock options | 87 | 14 |
| Deficit | (12,961) | (47,970) |
| Accumulated other comprehensive income | 21,146 | 15,113 |
| Total shareholders' equity | <u>189,927</u> | <u>148,743</u> |
| Total liabilities and shareholders' equity | <u>€1,370,798</u> | <u>€1,393,816</u> |

The accompanying notes are an integral part of these financial statements.

MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
For Six Months Ended June 30, 2006 and 2005
(Unaudited)
(Euros in thousands, except for per share data)

| | <u>2006</u> | <u>2005</u> |
|---|------------------|-------------------|
| Revenues | €325,769 | € 227,502 |
| Costs and expenses: | | |
| Cost of sales | 298,045 | 210,167 |
| General and administrative expenses | 27,724 | 17,335 |
| Sale of emission allowances | (18,591) | (15,316) |
| Income from operations | 13,246 | 6,288 |
| | <u>22,379</u> | <u>8,307</u> |
| Other income (expense) | | |
| Interest expense | (46,037) | (41,463) |
| Investment income | 3,011 | 981 |
| Unrealized foreign exchange gain (loss) on debt | 12,173 | (7,509) |
| Realized loss on derivative instruments | (5,219) | (295) |
| Unrealized gain (loss) on derivative instruments | 90,724 | (73,015) |
| Impairment of investments | — | (1,645) |
| Total other income (expense) | <u>54,652</u> | <u>(122,946)</u> |
| Income (loss) before income taxes and minority interest | 77,031 | (114,639) |
| Income tax (provision) benefit | (42,920) | 21,412 |
| Income (loss) before minority interest | 34,111 | (93,227) |
| Minority interest | 898 | 11,409 |
| Net income (loss) | € 35,009 | € (81,818) |
| (Deficit) retained earnings, beginning of period | (47,970) | 69,176 |
| Deficit, end of period | <u>€(12,961)</u> | <u>€ (12,642)</u> |
| Income (loss) per share | | |
| Basic | € 1.06 | € (2.80) |
| Diluted | <u>€ 0.86</u> | <u>€ (2.80)</u> |

The accompanying notes are an integral part of these financial statements.

MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
For Three Months Ended June 30, 2006 and 2005
(Unaudited)
(Euros in thousands, except for per share data)

| | <u>2006</u> | <u>2005</u> |
|---|-------------------|-------------------|
| Revenues | €166,705 | € 129,609 |
| Costs and expenses: | | |
| Cost of sales | 153,706 | 119,178 |
| General and administrative expenses | 12,999 | 10,431 |
| Sale of emission allowances | (9,733) | (7,518) |
| Income from operations | 7,608 | 6,288 |
| | <u>10,874</u> | <u>9,201</u> |
| Other income (expense) | | |
| Interest expense | (23,112) | (22,200) |
| Investment income | 1,267 | 806 |
| Unrealized foreign exchange gain (loss) on debt | 6,060 | (9,806) |
| Realized loss on derivative instruments | (1,657) | — |
| Unrealized gain (loss) on derivative instruments | 46,347 | (69,451) |
| Total other income (expense) | <u>28,905</u> | <u>(100,651)</u> |
| Income (loss) before income taxes and minority interest | 39,779 | (91,450) |
| Income tax (provision) benefit | (21,807) | 24,447 |
| Income (loss) before minority interest | 17,972 | (67,003) |
| Minority interest | 449 | 4,852 |
| Net income (loss) | <u>€ 18,421</u> | <u>€ (62,151)</u> |
| (Deficit) retained earnings, beginning of period | (31,382) | 49,509 |
| Deficit, end of period | <u>€ (12,961)</u> | <u>€ (12,642)</u> |
| Income (loss) per share | | |
| Basic | <u>€ 0.56</u> | <u>€ (1.88)</u> |
| Diluted | <u>€ 0.45</u> | <u>€ (1.88)</u> |

The accompanying notes are an integral part of these financial statements.

MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF
COMPREHENSIVE INCOME (LOSS)

For Six Months Ended June 30, 2006 and 2005
(Unaudited)
(Euros in thousands)

| | <u>2006</u> | <u>2005</u> |
|--|----------------|------------------|
| Net income (loss) | €35,009 | €(81,818) |
| Other comprehensive gain: | | |
| Foreign currency translation adjustment | 5,360 | 1,118 |
| Pension plan additional minimum liability | (17) | — |
| Unrealized gains on securities | | |
| Unrealized holding gains arising during the period | <u>690</u> | <u>305</u> |
| Other comprehensive gain | <u>6,033</u> | <u>1,423</u> |
| Total comprehensive income (loss) | <u>€41,042</u> | <u>€(80,395)</u> |

The accompanying notes are an integral part of these financial statements.

MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF
COMPREHENSIVE INCOME (LOSS)
For Three Months Ended June 30, 2006 and 2005
(Unaudited)
(Euros in thousands)

| | <u>2006</u> | <u>2005</u> |
|--|----------------|------------------|
| Net income (loss) | €18,421 | €(62,151) |
| Other comprehensive gain: | | |
| Foreign currency translation adjustment | 8,345 | 1,750 |
| Pension plan additional minimum liability | 2 | — |
| Unrealized gains on securities | | |
| Unrealized holding gains arising during the period | <u>569</u> | <u>—</u> |
| Other comprehensive gain | <u>8,916</u> | <u>1,750</u> |
| Total comprehensive income (loss) | <u>€27,337</u> | <u>€(60,401)</u> |

The accompanying notes are an integral part of these financial statements.

MERCER INTERNATIONAL INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
For Six Months Ended June 30, 2006 and 2005
(Unaudited)
(Euros in thousands)

| | <u>2006</u> | <u>2005</u> |
|--|-----------------|------------------|
| Cash Flows from (used in) Operating Activities: | | |
| Net income (loss) | € 35,009 | € (81,818) |
| Adjustments to reconcile net income (loss) to cash flows from operating activities | | |
| Unrealized (gains) losses on derivatives | (85,505) | 73,015 |
| Depreciation and amortization | 29,082 | 25,299 |
| Unrealized foreign exchange (gain) loss on debt | (12,173) | 7,509 |
| Impairment of investments and securities | — | 1,645 |
| Minority interest | (898) | (11,409) |
| Deferred income taxes | 42,567 | (21,638) |
| Stock compensation expense | 207 | 72 |
| Other | (490) | 125 |
| | | |
| Changes in current assets and liabilities | | |
| Receivables | (13,486) | (20,742) |
| Inventories | 10,670 | (16,757) |
| Accounts payable and accrued expenses | (3,347) | 41,319 |
| Other | (252) | (1,853) |
| Net cash from (used in) operating activities | <u>1,384</u> | <u>(5,233)</u> |
| | | |
| Cash Flows used in Investing Activities: | | |
| Cash restricted | (40,817) | 35,808 |
| Purchase of property, plant and equipment | (15,439) | (8,493) |
| Acquisition of Celgar pulp mill | — | (146,608) |
| Net cash used in investing activities | <u>(56,256)</u> | <u>(119,293)</u> |
| | | |
| Cash Flows from Financing Activities: | | |
| Decrease in construction costs payable | (212) | (31,346) |
| Proceeds from borrowings of notes payable and debt | 48,634 | 325,195 |
| Repayment of notes payable and debt | (375) | (183,691) |
| Proceeds from investment grants | — | 342 |
| Repayment of capital lease obligations | (2,431) | (1,907) |
| Issuance of shares of common stock | 69 | 66,645 |
| Net cash from financing activities | <u>45,685</u> | <u>175,238</u> |
| | | |
| Effect of exchange rate changes on cash and cash equivalents | <u>(1,281)</u> | <u>5,594</u> |
| Net (decrease) increase in cash and cash equivalents | (10,468) | 56,306 |
| Cash and cash equivalents, beginning of period | <u>83,547</u> | <u>49,568</u> |
| Cash and cash equivalents, end of period | <u>€ 73,079</u> | <u>€ 105,874</u> |

The accompanying notes are an integral part of these financial statements.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED June 30, 2006

(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 1. Basis of Presentation

Effective March 1, 2006, the Company was converted from a business trust organized under the laws of the State of Washington to a corporation organized under the laws of the State of Washington. The conversion was effected through the merger of Mercer Inc. with and into an indirect wholly owned Delaware subsidiary company followed by a merger with a direct wholly owned Washington subsidiary company. The conversion effected a change in the Company's legal form, but did not result in any change in its business, management, fiscal year, accounting practices, assets or liabilities (except to the extent of legal and other costs of effecting the conversion and maintaining ongoing corporate status) or location of its principal executive offices and facilities. The Company continues to operate under the name "Mercer International Inc." following consummation of the conversion and continues to be engaged in the same business that it was engaged in prior to the conversion and its shares of common stock are quoted and listed for trading on the NASDAQ National Market and the Toronto Stock Exchange, respectively.

The interim period consolidated financial statements contained herein include the accounts of Mercer International Inc. ("Mercer Inc.") and its wholly-owned and majority-owned subsidiaries (collectively, the "Company").

The interim period consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such SEC rules and regulations. The interim period consolidated financial statements should be read together with the audited consolidated financial statements and accompanying notes included in the Company's latest annual report on Form 10-K for the fiscal year ended December 31, 2005. In the opinion of the Company, the unaudited consolidated financial statements contained herein contain all adjustments necessary to present a fair statement of the results of the interim periods presented. The results for the periods presented herein may not be indicative of the results for the entire year.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2006

(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 2. Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*, on January 1, 2006. This statement requires the Company to recognize the cost of employee services received in exchange for the Company's equity instruments. Under SFAS No. 123R, the Company is required to record compensation expense over an award's vesting period based on the award's fair value at the date of grant. The Company has elected to adopt SFAS No. 123R on a modified prospective basis; accordingly, the financial statements for periods prior to January 1, 2006 will not include compensation cost calculated under the fair value method.

Prior to January 1, 2006, the Company applied Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees*, and, therefore, recorded the intrinsic value of stock-based compensation as expense and applied the disclosure provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation prior to January 1, 2006.

| | Six Months Ended June 30, 2005 |
|---|---|
| Net Loss | |
| As reported | € (81,818) |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of any related tax effects | (21) |
| Pro forma | € (81,839) |
| Basic and Diluted Loss Per Share | |
| As reported | € (2.80) |
| Pro forma | € (2.80) |
| | Three Months Ended June 30, 2005 |
| Net Loss | |
| As reported | € (62,151) |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of any related tax effects | (11) |
| Pro forma | € (62,162) |
| Basic and Diluted Loss Per Share | |
| As reported | € (1.88) |
| Pro forma | € (1.88) |

The fair value of each option granted is estimated on the grant date using the Black-Scholes model. During the six month period ended June 30, 2006 and 2005, no options were granted, exercised or cancelled.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2006

(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 2. Stock-Based Compensation (cont'd)

Summarized information about stock options outstanding and exercisable at June 30, 2006 is as follows:

| <u>Outstanding Options</u> | | | | <u>Exercisable Options</u> | |
|--|------------------|---|---|----------------------------|---|
| <u>Exercise Price Range</u> (In U.S. Dollars) | <u>Number</u> | <u>Weighted Average Remaining Contractual Life</u> (Years) | <u>Weighted Average Exercise price</u> (In U.S. Dollars) | <u>Number</u> | <u>Weighted Average Exercise Price</u> (In U.S. Dollars) |
| \$5.65 - 6.375 | 920,000 | 4.00 | \$ 6.30 | 886,666 | \$ 6.32 |
| 8.50 | 135,000 | 1.00 | 8.50 | 135,000 | 8.50 |
| 7.30 | 30,000 | 9.00 | 7.30 | 10,000 | 7.30 |
| 7.92 | 100,000 | 9.25 | 7.92 | 33,333 | 7.92 |
| | <u>1,185,000</u> | | <u>\$ 6.71</u> | <u>1,064,999</u> | <u>\$ 6.66</u> |

As at June 30, 2006, the total remaining unrecognized compensation cost related to non-vested stock options amounted to € 218, which will be amortized over their remaining vesting period.

During the six-month period ended June 30, 2006, there was no change in the number of non-vested options.

Restricted Stock

The fair value of restricted stock is determined based upon the number of shares granted and the quoted price of the Company's stock on the date of grant. Restricted stock generally vests over two years. Expense is recognized on a straight-line basis over the vesting period. Expense recognized for the six months ended June 30, 2006 and 2005 was € 207 and € 72, respectively.

As at June 30, 2006, the total remaining unrecognized compensation cost related to restricted stock amounted to €240, which will be amortized over their remaining vesting period.

During the six month period ended June 30, 2006, there were restricted stock awards of an aggregate of 10,000 of our common shares to independent directors.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2006

(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 3. Income (Loss) Per Share

Basic income (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of shares outstanding during a period. Diluted income (loss) per share takes into consideration shares outstanding (computed under basic earnings (loss) per share) and potentially dilutive shares. The following table sets out the computation of basic income (loss) per share for the six and three months ended June 30, 2006 and 2005, respectively:

| | <u>Six Months Ended June 30,</u> | | <u>Three Months Ended June 30,</u> | |
|---|----------------------------------|-------------------|------------------------------------|-------------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Income (loss) from continuing operations – basic | € 35,009 | € (81,818) | € 18,421 | € (62,151) |
| Interest on convertible notes, net of tax | 2,767 | — | 1,441 | — |
| Income (loss) from continuing operations – diluted | <u>€ 37,776</u> | <u>€ (81,818)</u> | <u>€ 19,862</u> | <u>€ (62,151)</u> |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 33,169,637 | 29,270,388 | 33,170,129 | 33,055,103 |
| Effect of dilutive shares: | | | | |
| Stock options and awards | 274,686 | — | 292,002 | — |
| Convertible notes | <u>10,645,161</u> | <u>—</u> | <u>10,645,161</u> | <u>—</u> |
| Diluted | <u>44,089,484</u> | <u>29,270,388</u> | <u>44,107,292</u> | <u>33,055,103</u> |
| Income (loss) from continuing operations per share: | | | | |
| Basic | <u>€ 1.06</u> | <u>€ (2.80)</u> | <u>€ 0.56</u> | <u>€ (1.88)</u> |
| Diluted | <u>€ 0.86</u> | <u>€ (2.80)</u> | <u>€ 0.45</u> | <u>€ (1.88)</u> |

The calculation of diluted income (loss) per share for the comparative 2005 period does not assume the exercise of stock options and awards or the conversion of convertible notes that would have an anti-dilutive effect on earnings per share. Stock options and awards excluded from the calculation of diluted income (loss) per share because they are anti-dilutive represented 253,969 for the six months ended June 30, 2005. Convertible notes excluded from the calculation of diluted income (loss) per share because they are anti-dilutive represented 10,645,161 for the six months ended June 30, 2005.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2006

(Unaudited)

(Euros in thousands, except for shares and per share data)

Note 4. Acquisition of the Celgar Mill and Related Financings

Acquisition

On February 14, 2005, the Company completed its acquisition of the Celgar NBSK pulp mill. The aggregate consideration for the acquisition was € 177,422, which included € 142,940 in cash, acquisition related expenditures of € 3,668 and € 30,814 was paid in common shares of the Company. The results of the Celgar mill are included in the consolidated statement of operations since the acquisition date.

The allocation of the purchase price is summarized below.

| | |
|---|-----------------|
| Purchase price: | |
| Cash (including defined working capital) | €142,940 |
| Equity – common shares | 30,814 |
| Acquisition costs | 3,668 |
| | <u>€177,422</u> |
| | |
| Net assets acquired: | |
| Receivables | € 32 |
| Inventories | 19,969 |
| Prepays and other assets | 616 |
| Property, plant and equipment | 175,096 |
| Accrued expenses and other liabilities | (4,103) |
| Pension plan and post-retirement benefits obligations | (14,188) |
| | <u>€177,422</u> |

In October 2005, our wholly owned subsidiary, Zellstoff Celgar Limited, received a re-assessment for real property transfer tax payable in British Columbia, Canada, in the amount of approximately € 3.5 million in connection with the transfer of the land where the Celgar mill is situated. The Company is contesting the assessment and the amount, if any, that may be payable in connection therewith is not yet determinable. Any additional amount paid in connection with the re-assessment will increase the cost basis of the assets acquired.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2006

(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 5. Business Segment Information

The Company operates in two reportable business segments: pulp and paper. The segments are managed separately because each business requires different production and marketing strategies. The results of the Celgar mill presented below are from the date of its acquisition on February 14, 2005.

Summarized financial information concerning the segments is shown in the following table:

| | <u>Rosenthal Pulp</u> | <u>Celgar Pulp</u> | <u>Stendal Pulp</u> | <u>Total Pulp</u> | <u>Paper</u> | <u>Corporate, Other and Eliminations</u> | <u>Consolidated Total</u> |
|--|---------------------------|---------------------------------------|-------------------------|-----------------------|----------------|--|-------------------------------|
| Six Months Ended June 30, 2006 | | | | | | | |
| Sales to external customers | € 68,941 | €100,811 | €122,510 | € 292,262 | €33,507 | € — | € 325,769 |
| Intersegment net sales | (152) | 23 | 4,688 | 4,559 | 108 | (4,667) | — |
| | <u>68,789</u> | <u>100,834</u> | <u>127,198</u> | <u>296,821</u> | <u>33,615</u> | <u>(4,667)</u> | <u>325,769</u> |
| Operating costs | 49,453 | 98,702 | 95,571 | 243,726 | 29,971 | (4,434) | 269,263 |
| Operating depreciation and amortization | 7,750 | 6,291 | 14,129 | 28,170 | 456 | 156 | 28,782 |
| General and administrative | 3,592 | 4,939 | 5,940 | 14,471 | 2,276 | 1,844 | 18,591 |
| (Sale) purchase of emission allowances | (3,651) | — | (9,595) | (13,246) | — | — | (13,246) |
| | <u>57,144</u> | <u>109,932</u> | <u>106,045</u> | <u>273,121</u> | <u>32,703</u> | <u>(2,434)</u> | <u>303,390</u> |
| Income (loss) from operations | 11,645 | (9,098) | 21,153 | 23,700 | 912 | (2,233) | 22,379 |
| Interest expense | | | | | | | (46,037) |
| Investment income | | | | | | | 3,011 |
| Derivative financial instruments, net | | | | | | | 85,505 |
| Unrealized foreign exchange gain on debt | | | | | | | 12,173 |
| Income before income taxes and minority interest | | | | | | | <u>€ 77,031</u> |
| Segment assets | <u>€332,485</u> | <u>€237,175</u> | <u>€746,557</u> | <u>€1,316,217</u> | <u>€22,020</u> | <u>€ 32,561</u> | <u>€1,370,798</u> |
| | <u>Rosenthal Pulp</u> | <u>Celgar ⁽¹⁾ Pulp</u> | <u>Stendal Pulp</u> | <u>Total Pulp</u> | <u>Paper</u> | <u>Corporate, Other and Eliminations</u> | <u>Consolidated Total</u> |
| Six Months Ended June 30, 2005 | | | | | | | |
| Sales to external customers | € 65,936 | € 48,480 | € 81,606 | € 196,022 | €31,480 | € — | € 227,502 |
| Intersegment net sales | — | — | 3,340 | 3,340 | — | (3,340) | — |
| | <u>65,936</u> | <u>48,480</u> | <u>84,946</u> | <u>199,362</u> | <u>31,480</u> | <u>(3,340)</u> | <u>227,502</u> |
| Operating costs | 47,405 | 40,554 | 71,546 | 159,505 | 29,601 | (3,822) | 185,284 |
| Operating depreciation and amortization | 6,630 | 4,097 | 13,454 | 24,181 | 379 | 323 | 24,883 |
| General and administrative | 3,810 | 2,837 | 1,677 | 8,324 | 2,562 | 4,430 | 15,316 |
| (Sale) purchase of emission allowances | (2,135) | — | (4,153) | (6,288) | — | — | (6,288) |
| | <u>55,710</u> | <u>47,488</u> | <u>82,524</u> | <u>185,722</u> | <u>32,542</u> | <u>931</u> | <u>219,195</u> |
| Income (loss) from operations | 10,226 | 992 | 2,422 | 13,640 | (1,062) | (4,271) | 8,307 |
| Interest expense | | | | | | | (41,463) |
| Investment income | | | | | | | 981 |
| Derivative financial instruments, net | | | | | | | (73,310) |
| Unrealized foreign exchange loss on debt | | | | | | | (7,509) |
| Impairment of investments | | | | | | | (1,645) |
| Loss before income taxes and minority interest | | | | | | | <u>€ (114,639)</u> |

| | | | | | | | |
|----------------|-----------------|-----------------|-----------------|-------------------|----------------|-----------------|-------------------|
| Segment assets | <u>€347,935</u> | <u>€244,361</u> | <u>€906,244</u> | <u>€1,498,540</u> | <u>€24,294</u> | <u>€ 15,995</u> | <u>€1,538,829</u> |
|----------------|-----------------|-----------------|-----------------|-------------------|----------------|-----------------|-------------------|

(1) The results of the Celgar pulp mill are from the date of its acquisition on February 14, 2005.

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(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 5. Business Segment Information (cont'd)

| | Rosenthal Pulp | Celgar Pulp | Stendal Pulp | Total Pulp | Paper | Corporate, Other and Eliminations | Consolidated Total |
|--|-------------------|----------------|-----------------|----------------|---------------|---|-----------------------|
| Three Months Ended June 30, 2006 | | | | | | | |
| Sales to external customers | €34,269 | €54,514 | €61,811 | €150,594 | €16,111 | € — | € 166,705 |
| Intersegment net sales | (194) | 23 | 2,373 | 2,202 | 108 | (2,310) | — |
| | <u>34,075</u> | <u>54,537</u> | <u>64,184</u> | <u>152,796</u> | <u>16,219</u> | <u>(2,310)</u> | <u>166,705</u> |
| Operating costs | 25,466 | 53,137 | 47,446 | 126,049 | 14,453 | (1,664) | 138,838 |
| Operating depreciation and amortization | 4,213 | 3,277 | 7,070 | 14,560 | 230 | 78 | 14,868 |
| General and administrative | 2,265 | 2,815 | 3,183 | 8,263 | 1,135 | 335 | 9,733 |
| (Sale) purchase of emission allowances | (1,884) | — | (5,724) | (7,608) | — | — | (7,608) |
| | <u>30,060</u> | <u>59,229</u> | <u>51,975</u> | <u>141,264</u> | <u>15,818</u> | <u>(1,251)</u> | <u>155,831</u> |
| Income (loss) from operations | 4,015 | (4,692) | 12,209 | 11,532 | 401 | (1,059) | 10,874 |
| Interest expense | | | | | | | (23,112) |
| Investment income | | | | | | | 1,267 |
| Derivative financial instruments, net | | | | | | | 44,690 |
| Unrealized foreign exchange gain on debt | | | | | | | 6,060 |
| Income before income taxes and minority interest | | | | | | | <u>€ 39,779</u> |

| | Rosenthal Pulp | Celgar Pulp | Stendal Pulp | Total Pulp | Paper | Corporate, Other and Eliminations | Consolidated Total |
|--|-------------------|----------------|-----------------|----------------|---------------|---|-----------------------|
| Three Months Ended June 30, 2005 | | | | | | | |
| Sales to external customers | €31,840 | €40,864 | €40,808 | €113,512 | €16,097 | € — | € 129,609 |
| Intersegment net sales | — | — | 1,786 | 1,786 | — | (1,786) | — |
| | <u>31,840</u> | <u>40,864</u> | <u>42,594</u> | <u>115,298</u> | <u>16,097</u> | <u>(1,786)</u> | <u>129,609</u> |
| Operating costs | 22,217 | 35,419 | 34,411 | 92,047 | 15,370 | (2,135) | 105,282 |
| Operating depreciation and amortization | 3,362 | 3,274 | 6,773 | 13,409 | 198 | 289 | 13,896 |
| General and administrative | 1,909 | 1,162 | 702 | 3,773 | 1,326 | 2,419 | 7,518 |
| (Sale) purchase of emission allowances | (2,135) | — | (4,153) | (6,288) | — | — | (6,288) |
| | <u>25,353</u> | <u>39,855</u> | <u>37,733</u> | <u>102,941</u> | <u>16,894</u> | <u>573</u> | <u>120,408</u> |
| Income (loss) from operations | 6,487 | 1,009 | 4,861 | 12,357 | (797) | (2,359) | 9,201 |
| Interest expense | | | | | | | (22,200) |
| Investment income | | | | | | | 806 |
| Derivative financial instruments, net | | | | | | | (69,451) |
| Unrealized foreign exchange loss on debt | | | | | | | (9,806) |
| Loss before income taxes and minority interest | | | | | | | <u>€ (91,450)</u> |

MERCER INTERNATIONAL INC.
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Note 6. Inventories

| | June 30, 2006 | December 31, 2005 |
|----------------|-----------------|-------------------|
| Raw materials | € 44,277 | € 42,649 |
| Finished goods | 25,267 | 38,498 |
| | <u>€ 69,544</u> | <u>€ 81,147</u> |

Note 7. Pension and Other Post-Retirement Benefit Obligations

Included in pension and other post-retirement benefit obligations are amounts related to our Celgar and German pulp mills.

The Celgar mill maintains defined benefit pension and post-retirement benefit plans for certain employees. Pension benefits are based on employees' earnings and years of service. The pension plans are funded by contributions from the Company based on management's best estimates. Pension contributions for the six month period ended June 30, 2006 and the period from acquisition to June 30, 2005 totaled € 908 and € 369, respectively.

| | Six Months Ended June 30, | | | |
|--------------------------------|---------------------------|--------------------------|------------------|--------------------------|
| | 2006 | | 2005 | |
| | Pension Benefits | Post-Retirement Benefits | Pension Benefits | Post-Retirement Benefits |
| Service cost | € 448 | € 227 | € 245 | € 107 |
| Interest cost | 706 | 382 | 481 | 234 |
| Expected return on plan assets | (786) | — | (471) | — |
| Recognized net loss | — | 50 | — | — |
| Net periodic benefit cost | <u>€ 368</u> | <u>€ 659</u> | <u>€ 255</u> | <u>€ 341</u> |

| | Three Months Ended June 30, | | | |
|--------------------------------|-----------------------------|--------------------------|------------------|--------------------------|
| | 2006 | | 2005 | |
| | Pension Benefits | Post-Retirement Benefits | Pension Benefits | Post-Retirement Benefits |
| Service cost | € 222 | € 112 | € 161 | € 58 |
| Interest cost | 350 | 190 | 323 | 146 |
| Expected return on plan assets | (389) | — | (321) | — |
| Recognized net loss | — | 25 | — | — |
| Net periodic benefit cost | <u>€ 183</u> | <u>€ 327</u> | <u>€ 163</u> | <u>€ 204</u> |

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(Unaudited)
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Note 8. Derivatives Transactions

| | <u>Six Months Ended June 30,</u> | |
|--|------------------------------------|-------------|
| | <u>2006</u> | <u>2005</u> |
| Realized loss on derivative financial instruments | € (5,219) | € (295) |
| Unrealized net gain (loss) on interest rate derivatives | 36,326 | (20,475) |
| Unrealized net gain (loss) on foreign exchange derivatives | 54,398 | (52,540) |
| Unrealized gain (loss) on derivative financial instruments | €90,724 | €(73,015) |
| | <u>Three Months Ended June 30,</u> | |
| | <u>2006</u> | <u>2005</u> |
| Realized loss on derivative financial instruments | € (1,657) | € — |
| Unrealized net gain (loss) on interest rate derivatives | 12,820 | (20,819) |
| Unrealized net gain (loss) on foreign exchange derivatives | 33,527 | (48,632) |
| Unrealized gain (loss) on derivative financial instruments | €46,347 | €(69,451) |

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
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(Unaudited)
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Note 9. Restricted Group Supplemental Disclosure

The terms of the indenture governing our 9.25% senior unsecured notes requires that we provide the results of operations and financial condition of Mercer Inc. and our restricted subsidiaries under the indenture, collectively referred to as the "Restricted Group". From February 14, 2005, the Restricted Group includes Mercer Inc., certain holding subsidiaries, Rosenthal and the Celgar mill. The Restricted Group excludes our paper operations and the Stendal mill.

Combined Condensed Balance Sheet

| | June 30, 2006 | | | |
|--|-----------------------------|--------------------------------------|---------------------|-------------------------------|
| | <u>Restricted Group</u> | <u>Unrestricted Subsidiaries</u> | <u>Eliminations</u> | <u>Consolidated Group</u> |
| ASSETS | | | | |
| Current assets | | | | |
| Cash and cash equivalents | € 37,018 | € 36,061 | € — | € 73,079 |
| Cash restricted | — | 5,892 | — | 5,892 |
| Receivables | 47,468 | 39,552 | — | 87,020 |
| Inventories | 36,653 | 32,891 | — | 69,544 |
| Prepaid expenses and other | 3,620 | 2,620 | — | 6,240 |
| Total current assets | <u>124,759</u> | <u>117,016</u> | — | <u>241,775</u> |
| Cash restricted | — | 66,537 | — | 66,537 |
| Property, plant and equipment | 400,046 | 608,273 | — | 1,008,319 |
| Other | 10,048 | 5,321 | — | 15,369 |
| Deferred income tax | 18,149 | 20,649 | — | 38,798 |
| Due from unrestricted group | 49,302 | — | (49,302) | — |
| Total assets | <u>€602,304</u> | <u>€ 817,796</u> | <u>€ (49,302)</u> | <u>€1,370,798</u> |
| LIABILITIES | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued expenses | € 43,851 | € 65,262 | € — | € 109,113 |
| Debt, current portion | — | 75,375 | — | 75,375 |
| Total current liabilities | <u>43,851</u> | <u>140,637</u> | — | <u>184,488</u> |
| Debt, less current portion | 322,732 | 575,647 | — | 898,379 |
| Due to restricted group | — | 49,302 | (49,302) | — |
| Unrealized derivative loss | — | 54,055 | — | 54,055 |
| Other | 21,160 | 5,361 | — | 26,521 |
| Deferred income tax | 2,379 | 15,049 | — | 17,428 |
| Total liabilities | <u>390,122</u> | <u>840,051</u> | <u>(49,302)</u> | <u>1,180,871</u> |
| SHAREHOLDERS' EQUITY | | | | |
| Total shareholders' equity (deficit) | <u>212,182</u> | <u>(22,255) ⁽¹⁾</u> | — | <u>189,927</u> |
| Total liabilities and shareholders' equity | <u>€602,304</u> | <u>€ 817,796</u> | <u>€ (49,302)</u> | <u>€1,370,798</u> |

(1) Shareholders' equity does not include government grants received or receivable related to the Stendal mill. Shareholders' equity is impacted by the unrealized non-cash marked to market valuation losses on derivative financial instruments.

MERCER INTERNATIONAL INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
FOR SIX MONTHS ENDED JUNE 30, 2006

(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 9. Restricted Group Supplemental Disclosure (cont'd)

Combined Condensed Balance Sheet

| | December 31, 2005 | | | Consolidated Group |
|--|---------------------|------------------------------|-------------------|-----------------------|
| | Restricted Group | Unrestricted Subsidiaries | Eliminations | |
| ASSETS | | | | |
| Current | | | | |
| Cash and cash equivalents | € 48,790 | € 34,757 | € — | € 83,547 |
| Cash restricted | — | 7,039 | — | 7,039 |
| Receivables | 41,349 | 32,966 | — | 74,315 |
| Inventories | 47,100 | 34,047 | — | 81,147 |
| Prepaid expenses and other | 2,940 | 2,534 | — | 5,474 |
| Total current assets | 140,179 | 111,343 | — | 251,522 |
| Cash restricted | — | 24,573 | — | 24,573 |
| Property, plant and equipment | 404,151 | 620,511 | — | 1,024,662 |
| Other | 10,533 | 4,145 | — | 14,678 |
| Deferred income tax | 24,303 | 54,078 | — | 78,381 |
| Due from unrestricted group | 46,412 | — | (46,412) | — |
| Total assets | <u>€625,578</u> | <u>€ 814,650</u> | <u>€ (46,412)</u> | <u>€1,393,816</u> |
| LIABILITIES | | | | |
| Current | | | | |
| Accounts payable and accrued expenses | € 46,867 | € 65,859 | € — | € 112,726 |
| Debt, current portion | — | 27,601 | — | 27,601 |
| Total current liabilities | 46,867 | 93,460 | — | 140,327 |
| Debt, less current portion | 342,023 | 580,596 | — | 922,619 |
| Due to restricted group | — | 46,412 | (46,412) | — |
| Unrealized derivative loss | — | 140,625 | — | 140,625 |
| Other | 20,722 | 6,336 | — | 27,058 |
| Deferred income tax | 1,851 | 12,593 | — | 14,444 |
| Total liabilities | <u>411,463</u> | <u>880,022</u> | <u>(46,412)</u> | <u>1,245,073</u> |
| SHAREHOLDERS' EQUITY | | | | |
| Total shareholders' equity (deficit) | 214,115 | (65,372) ⁽¹⁾ | — | 148,743 |
| Total liabilities and shareholders' equity | <u>€625,578</u> | <u>€ 814,650</u> | <u>€ (46,412)</u> | <u>€1,393,816</u> |

(1) Shareholders' equity does not include government grants received or receivable related to the Stendal mill. Shareholders' equity is impacted by the unrealized non-cash marked to market valuation losses on derivative financial instruments.

MERCER INTERNATIONAL INC.
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(Unaudited)
(Euros in thousands, except for shares and per share data)

Note 9. Restricted Group Supplemental Disclosure (cont'd)

Combined Condensed Statement of Operations

| | Six Months Ended June 30, 2006 | | | |
|---|--------------------------------|---------------------------|----------------|--------------------|
| | Restricted Group | Unrestricted Subsidiaries | Eliminations | Consolidated Group |
| Revenues | €169,623 | € 160,813 | € (4,667) | € 325,769 |
| Operating costs | 148,388 | 125,309 | (4,434) | 269,263 |
| Operating depreciation and amortization | 14,197 | 14,585 | — | 28,782 |
| General and administrative expenses | 10,375 | 8,216 | — | 18,591 |
| (Sale) purchase of emission allowances | (3,651) | (9,595) | — | (13,246) |
| | <u>169,309</u> | <u>138,515</u> | <u>(4,434)</u> | <u>303,390</u> |
| Income from operations | 314 | 22,298 | (233) | 22,379 |
| Other income (expense) | | | | |
| Interest expense | (16,442) | (31,355) | 1,760 | (46,037) |
| Investment income | 2,119 | 2,652 | (1,760) | 3,011 |
| Derivative financial instruments, net | — | 85,505 | — | 85,505 |
| Unrealized foreign exchange gain on debt | 12,173 | — | — | 12,173 |
| Total other (expense) income | (2,150) | 56,802 | — | 54,652 |
| Income (loss) before income taxes and minority interest | (1,836) | 79,100 | (233) | 77,031 |
| Income tax provision | (6,905) | (36,015) | — | (42,920) |
| Income (loss) before minority interest | (8,741) | 43,085 | (233) | 34,111 |
| Minority interest | — | 898 | — | 898 |
| Net income (loss) | <u>€ (8,741)</u> | <u>€ 43,983</u> | <u>€ (233)</u> | <u>€ 35,009</u> |

| | Six Months Ended June 30, 2005 | | | |
|--|--------------------------------|---------------------------|----------------|--------------------|
| | Restricted Group | Unrestricted Subsidiaries | Eliminations | Consolidated Group |
| Revenues | €114,416 | € 113,086 | € — | € 227,502 |
| Operating costs | 87,260 | 98,024 | — | 185,284 |
| Operating depreciation and amortization | 10,829 | 13,616 | 438 | 24,883 |
| General and administrative | 11,077 | 4,239 | — | 15,316 |
| (Sale) purchase of emission allowances | (2,135) | (4,153) | — | (6,288) |
| | <u>107,031</u> | <u>111,726</u> | <u>438</u> | <u>219,195</u> |
| Income from operations | 7,385 | 1,360 | (438) | 8,307 |
| Other income (expense) | | | | |
| Interest expense | (15,985) | (26,571) | 1,093 | (41,463) |
| Investment income | 1,297 | 777 | (1,093) | 981 |
| Derivative financial instruments, net | (463) | (72,847) | — | (73,310) |
| Unrealized foreign exchange loss on debt | (7,509) | — | — | (7,509) |
| Impairment of investments | (1,645) | — | — | (1,645) |
| Total other expense | (24,305) | (98,641) | — | (122,946) |
| Loss before income taxes and minority interest | (16,920) | (97,281) | (438) | (114,639) |
| Income tax (provision) benefit | (4,776) | 26,188 | — | 21,412 |
| Loss before minority interest | (21,696) | (71,093) | (438) | (93,227) |
| Minority interest | — | 11,409 | — | 11,409 |
| Net loss | <u>€ (21,696)</u> | <u>€ (59,684)</u> | <u>€ (438)</u> | <u>€ (81,818)</u> |



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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
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(Unaudited)
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Note 9. Restricted Group Supplemental Disclosure (cont'd)

Combined Condensed Statement of Operations

| | Three Months Ended June 30, 2006 | | | |
|---|----------------------------------|------------------------------|----------------|-----------------------|
| | Restricted Group | Unrestricted Subsidiaries | Eliminations | Consolidated Group |
| Revenues | € 88,612 | € 80,403 | € (2,310) | € 166,705 |
| Operating costs | 79,249 | 61,253 | (1,664) | 138,838 |
| Operating depreciation and amortization | 7,568 | 7,300 | — | 14,868 |
| General and administrative expenses | 5,415 | 4,318 | — | 9,733 |
| (Sale) purchase of emission allowances | (1,884) | (5,724) | — | (7,608) |
| | <u>90,348</u> | <u>67,147</u> | <u>(1,664)</u> | <u>155,831</u> |
| Income (loss) from operations | <u>(1,736)</u> | <u>13,256</u> | <u>(646)</u> | <u>10,874</u> |
| Other income (expense) | | | | |
| Interest expense | (7,979) | (16,018) | 885 | (23,112) |
| Investment income | (142) | 2,294 | (885) | 1,267 |
| Derivative financial instruments, net | 79 | 44,611 | — | 44,690 |
| Unrealized foreign exchange gain on debt | 6,060 | — | — | 6,060 |
| Total other (expense) income | <u>(1,982)</u> | <u>30,887</u> | <u>—</u> | <u>28,905</u> |
| Income (loss) before income taxes and minority interest | (3,718) | 44,143 | (646) | 39,779 |
| Income tax provision | <u>(3,872)</u> | <u>(17,935)</u> | <u>—</u> | <u>(21,807)</u> |
| Income (loss) before minority interest | (7,590) | 26,208 | (646) | 17,972 |
| Minority interest | — | 449 | — | 449 |
| Net income (loss) | <u>€ (7,590)</u> | <u>€ 26,657</u> | <u>€ (646)</u> | <u>€ 18,421</u> |
| | | | | |
| | Three Months Ended June 30, 2005 | | | |
| | Restricted Group | Unrestricted Subsidiaries | Eliminations | Consolidated Group |
| Revenues | € 72,704 | € 56,905 | € — | € 129,609 |
| Operating costs | 57,287 | 47,995 | — | 105,282 |
| Operating depreciation and amortization | 6,704 | 6,971 | 221 | 13,896 |
| General and administrative | 5,490 | 2,028 | — | 7,518 |
| (Sale) purchase of emission allowances | (2,135) | (4,153) | — | (6,288) |
| | <u>67,346</u> | <u>52,841</u> | <u>221</u> | <u>120,408</u> |
| Income from operations | <u>5,358</u> | <u>4,064</u> | <u>(221)</u> | <u>9,201</u> |
| Other income (expense) | | | | |
| Interest expense | (8,314) | (14,585) | 699 | (22,200) |
| Investment income | 970 | 467 | (631) | 806 |
| Derivative financial instruments, net | (358) | (69,093) | — | (69,451) |
| Unrealized foreign exchange loss on debt | (9,806) | — | — | (9,806) |
| Impairment of investments | (467) | — | 467 | — |
| Total other income (expense) | <u>(17,975)</u> | <u>(83,211)</u> | <u>535</u> | <u>(100,651)</u> |
| Income (loss) before income taxes and minority interest | (12,617) | (79,147) | 314 | (91,450) |
| Income tax (provision) benefit | <u>(1,661)</u> | <u>26,108</u> | <u>—</u> | <u>24,447</u> |
| Income (loss) before minority interest | (14,278) | (53,039) | 314 | (67,003) |
| Minority interest | — | 4,852 | — | 4,852 |
| Net loss | <u>€ (14,278)</u> | <u>€ (48,187)</u> | <u>€ 314</u> | <u>€ (62,151)</u> |

Note 10. Subsequent Event

In August 2006, we reorganized and divested our equity interests in certain paper production assets, including our Heidenau paper mill, for aggregate consideration of approximately € 5.0 million of indebtedness and € 5.0 million in cash.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this document: (i) unless the context otherwise requires, references to "we", "our", "us", the "Company" or "Mercer" mean Mercer International Inc. and its subsidiaries; (ii) references to "Mercer Inc." mean the Company excluding its subsidiaries; (iii) information is provided as of June 30, 2006, unless otherwise stated; (iv) all references to monetary amounts are to "Euros", unless otherwise stated; (v) "€" refers to Euros and C\$ refers to Canadian dollars; and (vi) "ADMTs" refers to air-dried metric tonnes.

The following discussion and analysis of our results of operations and financial condition for the six months ended June 30, 2006 should be read in conjunction with our consolidated financial statements and related notes included in this quarterly report, as well as our most recent annual report on Form 10-K for the fiscal year ended December 31, 2005 filed with the Securities and Exchange Commission (the "SEC"). Certain reclassifications have been made to the prior period financial statements to conform with the current period presentation.

Results of Operations

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Selected sales data for the six months ended June 30, 2006 and 2005 is as follows:

| | <u>Six Months Ended June 30,</u> | |
|--|----------------------------------|----------------|
| | <u>2006</u> | <u>2005</u> |
| | (ADMTs) | |
| Sales Volume by Product Class | | |
| Pulp sales volume by mill: | | |
| Rosenthal | 149,236 | 154,800 |
| Stendal | 277,408 | 204,988 |
| Celgar | <u>229,722</u> | <u>118,188</u> |
| Total pulp sales volume ⁽¹⁾ | 656,366 | 477,976 |
| Paper sales volume | <u>32,084</u> | <u>34,478</u> |
| Total sales volume ⁽¹⁾ | <u>688,450</u> | <u>512,454</u> |

| | (in thousands) | |
|--|-----------------|-----------------|
| Revenues by Product Class | | |
| Pulp revenues by mill: | | |
| Rosenthal | € 67,545 | € 64,504 |
| Stendal | 120,522 | 80,873 |
| Celgar ⁽¹⁾ | <u>100,811</u> | <u>48,480</u> |
| Total pulp revenues ⁽¹⁾ | 288,878 | 193,857 |
| Paper revenues | <u>33,335</u> | <u>31,463</u> |
| Total pulp and paper sales revenues ⁽¹⁾ | 322,213 | 225,320 |
| Third party transportation revenues | <u>3,556</u> | <u>2,182</u> |
| Total sales revenues | <u>€325,769</u> | <u>€227,502</u> |

(1) Excluding intercompany sales volumes of 9,857 and 7,594 ADMTs of pulp and intercompany net sales revenues of approximately € 4.7 million and €3.3 million in the six months ended June 30, 2006 and 2005, respectively.

Selected production data for the six months ended June 30, 2006 and 2005 is as follows:

| | Six Months Ended June 30, | |
|------------------------------------|----------------------------------|-----------------------|
| | 2006 | 2005 |
| | (ADMTs) | |
| Production by Product Class | | |
| Pulp production by mill: | | |
| Rosenthal | 143,530 | 157,315 |
| Stendal | 270,592 | 231,719 |
| Celgar ⁽¹⁾ | <u>212,088</u> | <u>171,833</u> |
| Total pulp production | 626,210 | 560,867 |
| Paper production | <u>33,602</u> | <u>33,937</u> |
| Total production | <u><u>659,812</u></u> | <u><u>594,804</u></u> |

(1) The results of the Celgar pulp mill are included from the date of its acquisition on February 14, 2005.

Revenues for the six months ended June 30, 2006 increased to € 325.8 million from € 227.5 million in the comparative period of 2005, primarily due to higher sales from our Celgar and Stendal pulp mills. Pulp sales by volume increased to 656,366 ADMTs in the first half of 2006 from 477,976 ADMTs in the comparative period of 2005.

Cost of sales and general, administrative and other expenses in the first half of 2006 increased to €303.4 million from € 219.2 million in the comparative period of 2005, primarily as a result of higher sales from our Celgar and Stendal mills.

For the first half of 2006, revenues from our pulp operations increased to € 292.3 million from € 196 million in the same period a year ago. List prices for NBSK pulp in Europe were approximately € 522 (\$642) per ADMT in the first half of 2006 approximately € 488 (\$628) per ADMT in the first half of 2005 and approximately €506 (\$600) in the fourth quarter of 2005.

Mill net pulp sales realizations increased to € 440 per ADMT on average in the first half of 2006 from € 411 per ADMT in the first half of 2005, primarily as a result of higher pulp prices.

During the current period, we took an aggregate of 42 days scheduled maintenance and strategic capital expenditure downtime at our pulp mills, including 20 days at our Rosenthal mill and 13 days at our Celgar mill. During the downtime at our Rosenthal mill, we completed the installation of a new brownstock washer at a cost of approximately € 9.7 million, which is expected to further improve pulp quality and lower chemical costs and effluents. The total maintenance costs associated with such shutdowns were approximately €6.5 million and were expensed as incurred. This negatively impacted our production volumes, costs and operating results. The Stendal mill also underwent extensive testing of various departments and converted some production to TCF pulp pursuant to the terms of its EPC contract which curtailed production during such period. During the comparative period of 2005, our pulp mills took approximately 32 days maintenance and strategic capital expenditure downtime.

Cost of sales and general, administrative and other expenses for the pulp operations increased to € 273.1 million in the first half of 2006 from € 185.7 million in the comparative period of 2005 primarily as a result of higher sales from our Celgar and Stendal mills.

Fiber costs at our German pulp mills increased by approximately 9% in the first half of 2006 versus the same period of 2005. This resulted from lower availability because of severe winter conditions in Germany and central Europe, which caused sawmillers and log harvesters to curtail operations and increased competition for fiber primarily from renewable energy operations. The

increase in worldwide energy prices has made projects generating energy from renewable sources such as wood residuals more viable in Europe. As a result, there has been increased fiber demand and competition in our fiber base. In the first six months of 2006, average fiber costs at our Celgar mill decreased by approximately 18% versus the same period of 2005, primarily because of increased regional wood chip availability.

In the first half of 2006, we recorded a contribution to income from operations of € 13.2 million resulting from the sale of emission allowances compared to € 6.3 million in the comparative period of 2005.

Depreciation for the pulp operations increased to €28.2 million in the first half of 2006, from € 24.2 million in the first half of 2005, primarily as a result of the inclusion of depreciation for the Celgar mill for the full period.

For the first six months of 2006, our pulp operations generated operating income of € 23.7 million, versus operating income of €13.6 million in the same period of 2005, primarily due to improving pulp markets and the higher operating income at our German pulp mills, including a contribution of € 13.2 million from the sale of emission allowances, partially offset by maintenance and strategic capital expenditure downtime at our pulp mills. The overall strength of the Canadian dollar versus the U.S. dollar negatively impacted our Celgar mill's results.

Revenues from our paper operations in the first half of 2006 increased to € 33.5 million from € 31.5 million in the same period of last year as a result of higher sales volumes and a change in the product mix.

Cost of sales and general, administrative and other expenses for the paper operations in the first half of 2006 increased to € 32.7 million from € 32.5 million in the comparative quarter of 2005.

In the first half of 2006, our paper operations generated operating income of € 0.9 million, compared to an operating loss of € 1.1 million in the first half of 2005.

In the first half of 2006, income from operations increased to € 22.4 million from €8.3 million in the same period last year, primarily as a result of higher pulp prices and improved results from our German pulp mills.

Interest expense in the first half of 2006 increased to € 46.0 million from € 41.5 million in the year ago period, primarily due to higher borrowings relating to the Stendal mill.

Stendal entered into certain foreign currency derivatives to swap all of its long-term bank indebtedness from Euros to U.S. dollars in 2005 and certain currency forwards. In addition, Stendal previously entered into interest rate swaps to fix the interest rate on its outstanding bank indebtedness. Due to the weakening of the U.S. dollar versus the Euro and an increase in long-term interest rates, we recorded a net unrealized non-cash holding gain of € 90.7 million before minority interests upon the marked to market valuation of such derivatives that were outstanding at the end of the current period, compared to a net non-cash holding loss of € 73.0 million before minority interests upon the marked to market valuation of our outstanding derivatives in the comparative period of 2005. In the first six months of 2006 we recorded a realized loss in derivative instruments of € 5.2 million compared to a realized loss of € 0.3 million in the comparative period of 2005.

In the first half of 2006, minority interest, representing the two minority shareholders' proportionate interest in the Stendal mill's losses for the period, was € 0.9 million, compared to € 11.4 million in the first half of 2005.

We reported net income for the first six months of 2006 of € 35.0 million, or € 1.06 per basic and € 0.86 per diluted share, which reflected a net unrealized gain of € 85.5 million on our interest rate and currency derivatives, an unrealized non-cash foreign exchange gain on our long-term debt of € 12.2 million and improved results at our German pulp mills. In the first half of 2005, we reported a net loss of € 81.8 million, or € 2.80 per basic and diluted share, which reflected a net unrealized non-cash holding losses on our currency and interest rate derivatives of € 73.3 million and the unrealized non-cash foreign exchange loss on our long-term debt of € 7.5 million, partially offset by the non-cash benefit for income taxes of € 21.4 million, and interest expense related to our Stendal mill of € 26.3 million and a non-cash impairment charge of € 1.6 million relating to investments.

We generated "Operating EBITDA" of € 51.2 million and € 33.2 million in the six months ended June 30, 2006 and 2005, respectively. Operating EBITDA is defined as income (loss) from operations plus depreciation and amortization and non-recurring capital asset impairment charges.

Management uses Operating EBITDA as a benchmark measurement of its own operating results, and as a benchmark relative to its competitors. Management considers it to be a meaningful supplement to operating income as a performance measure primarily because depreciation expense and non-recurring capital asset impairment charges are not an actual cash cost, and depreciation expense varies widely from company to company in a manner that management considers largely independent of the underlying cost efficiency of their operating facilities. In addition, we believe Operating EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

Operating EBITDA does not reflect the impact of a number of items that affect our net income (loss), including financing costs and the effect of derivative instruments. Operating EBITDA is not a measure of financial performance under GAAP, and should not be considered as an alternative to net income (loss) or income (loss) from operations as a measure of performance, nor as an alternative to net cash from operating activities as a measure of liquidity.

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are that Operating EBITDA does not reflect: (i) our cash expenditures, or future requirements, for capital expenditures or contractual commitments; (ii) changes in, or cash requirements for, working capital needs; (iii) the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our outstanding debt; (iv) minority interests on our Stendal NBSK pulp mill operations; (v) the impact of realized or marked to market changes in our derivative positions, which can be substantial; and (vi) the impact of impairment charges against our investments or assets. Because of these limitations, Operating EBITDA should only be considered as a supplemental performance measure and should not be considered as a measure of liquidity or cash available to us to invest in the growth of our business. See the Statement of Cash Flows set out in our consolidated financial statements included herein. Because all companies do not calculate Operating EBITDA in the same manner, Operating EBITDA as calculated by us may differ from Operating EBITDA or EBITDA as calculated by other companies. We compensate for these limitations by using Operating

EBITDA as a supplemental measure of our performance and relying primarily on our GAAP financial statements.

The following table provides a reconciliation of net income (loss) to income from operations and Operating EBITDA for the periods indicated:

| | Six Months Ended June 30, | |
|---|------------------------------|---------------------|
| | 2006 | 2005 ⁽¹⁾ |
| | (in thousands) | |
| Net income (loss) | € 35,009 | €(81,818) |
| Minority interest | (898) | (11,409) |
| Income taxes (benefit) | 42,920 | (21,412) |
| Interest expense | 46,037 | 41,463 |
| Investment income | (3,011) | (981) |
| Derivative financial instruments, net (gain) loss | (85,505) | 73,310 |
| Foreign exchange (gain) loss on debt | (12,173) | 7,509 |
| Impairment of investments | — | 1,645 |
| Income from operations | 22,379 | 8,307 |
| Add: Depreciation and amortization | 28,782 | 24,883 |
| Operating EBITDA | <u>€ 51,161</u> | <u>€ 33,190</u> |

(1) The results of the Celgar pulp mill are included from the date of its acquisition on February 14, 2005.

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Selected sales data for the three months ended June 30, 2006 and 2005 is as follows:

| | Three Months Ended June 30, | |
|--|-----------------------------|----------------|
| | 2006 | 2005 |
| | (ADMTs) | |
| Sales Volume by Product Class | | |
| Pulp sales volume by mill: | | |
| Rosenthal | 73,010 | 75,996 |
| Stendal | 136,894 | 102,915 |
| Celgar | 119,361 | 99,841 |
| Total pulp sales volume ⁽¹⁾ | 329,265 | 278,752 |
| Paper sales volume | 15,482 | 17,840 |
| Total sales volume ⁽¹⁾ | <u>344,747</u> | <u>296,592</u> |

| | (in thousands) | |
|--|----------------------------------|-----------------|
| | Revenues by Product Class | |
| Pulp revenues by mill: | | |
| Rosenthal | € 33,776 | € 31,115 |
| Stendal | 60,741 | 40,345 |
| Celgar | 54,514 | 40,864 |
| Total pulp revenues ⁽¹⁾ | 149,031 | 112,324 |
| Paper revenues | 16,097 | 16,097 |
| Total pulp and paper sales revenues ⁽¹⁾ | 165,128 | 128,421 |
| Third party transportation revenues | 1,577 | 1,188 |
| Total sales revenues | <u>€166,705</u> | <u>€129,609</u> |

(1) Excluding intercompany sales volumes of 4,871 and 4,105 ADMTs of pulp and intercompany net sales revenues of approximately € 2.3 million and €1.7 million in the three months ended June 30, 2006 and 2005, respectively.

Selected production data for the three months ended June 30, 2006 and 2005 is as follows:

| | Three Months Ended June 30, | |
|------------------------------------|------------------------------------|-----------------------|
| | 2006 | 2005 |
| | (ADMTs) | |
| Production by Product Class | | |
| Pulp production by mill: | | |
| Rosenthal | 67,376 | 81,443 |
| Stendal | 139,715 | 123,738 |
| Celgar | <u>100,651</u> | <u>111,071</u> |
| Total pulp production | 307,742 | 316,252 |
| Paper production | <u>16,427</u> | <u>17,979</u> |
| Total production | <u><u>324,169</u></u> | <u><u>334,231</u></u> |

Revenues for the three months ended June 30, 2006 increased to € 166.7 million from € 129.6 million in the comparative period of 2005, primarily due to higher sales from our Celgar and Stendal pulp mills. Pulp sales by volume increased to 329,265 ADMTs in the second quarter of 2006 from 278,752 ADMTs in the comparative period of 2005.

Cost of sales and general, administrative and other expenses in the second quarter of 2006 increased to € 155.8 million from € 120.4 million in the comparative period of 2005, primarily as a result of higher sales from our Celgar and Stendal mills.

For the second quarter of 2006, revenues from our pulp operations increased to € 150.6 million from € 113.5 million in the same period a year ago. List prices for NBSK pulp in Europe were approximately € 529 (\$665) per ADMT in the second quarter of 2006, approximately € 514 (\$618) per ADMT in the first quarter of 2006, compared to approximately € 487 (\$613) per ADMT in the second quarter of 2005.

Mill net pulp sales realizations increased to € 453 per ADMT on average in the second quarter of 2006 from € 403 per ADMT in the second quarter of 2005, primarily as a result of higher pulp prices.

During the current quarter, we took an aggregate of approximately 30 days scheduled maintenance and strategic capital expenditure downtime at our pulp mills, including 16 days at our Rosenthal mill and 8 days at our Celgar mill. During the downtime at our Rosenthal mill, we completed the installation of a new brownstock washer at a cost of approximately € 9.7 million, which is expected to further improve pulp quality and lower chemical costs and effluents. The total maintenance costs associated with such shutdowns were approximately € 4.3 million and were expensed in the current quarter. The Stendal mill also underwent testing of various departments and converted some production to TCF pulp pursuant to the terms of its EPC contract which curtailed production during such period. Total production volume at our Rosenthal and Celgar mills was down by approximately 24,000 tonnes or 13% in the current quarter of 2006 compared to the same period of 2005. This negatively impacted our production volumes, costs and operating results. During the same period of 2005, we had 12 days of down time at our pulp mills.

Cost of sales and general, administrative and other expenses for the pulp operations increased to € 141.3 million in the second quarter of 2006 from € 102.9 million in the comparative period of 2005, primarily as a result of higher sales from our Celgar and Stendal mills.

Fiber costs at our German pulp mills increased by approximately 8% in the second quarter of 2006 versus the same period of 2005. This resulted from lower availability because of severe

winter conditions in Germany and central Europe, which caused sawmillers and log harvesters to curtail operations and increased competition for fiber primarily from renewable energy operations. In the second quarter of 2006, average fiber costs at our Celgar mill decreased by approximately 23% versus the same quarter of 2005, primarily because of fluctuations in regional wood chip availability. Subsequent to June 30, 2006, lower chip availability resulting from softer lumber markets and an increase in chip demand from coastal pulp and paper mills is expected to put upward pressure on Celgar's fiber costs in the second half of 2006.

In the second quarter of 2006, we recorded a contribution to income from operations of € 7.6 million resulting from the sale of emission allowances compared to € 6.3 million in the comparative quarter of 2005.

Depreciation for the pulp operations increased to €14.6 million in the second quarter of 2006, from €13.4 million in the comparative quarter of 2005.

For the second quarter of 2006, our pulp operations generated operating income of € 11.5 million, versus operating income of € 12.4 million in the comparative quarter of 2005 as scheduled downtime resulted in weaker performance by our pulp mills which offset improvements in markets and the improvements in Stendal's results. The overall strength of the Canadian dollar versus the U.S. dollar negatively impacted our Celgar mill's continued results.

Revenues from our paper operations were stable at €16.1 million in the current quarter as well as the same quarter of last year.

Cost of sales and general, administrative and other expenses for the paper operations in the second quarter of 2006 decreased to € 15.8 million from € 16.9 million in the comparative quarter of 2005.

For the second quarter of 2006, our paper operations generated operating income of € 0.4 million, compared to an operating loss of € 0.8 million in the second quarter of 2005.

In the second quarter of 2006, we had income from operations of € 10.9 million, compared to € 9.2 million in the same quarter last year. Interest expense in the second quarter of 2006 increased marginally to € 23.1 million from € 22.2 million in the year ago period, primarily due to higher borrowings relating to the Stendal mill.

Stendal entered into certain foreign currency derivatives to swap all of its long-term bank indebtedness from Euros to U.S. dollars in 2005 and certain currency forwards. In addition, Stendal previously entered into interest rate swaps to fix the interest rate on its outstanding bank indebtedness. Due to the weakening of the U.S. dollar versus the Euro and an increase in long-term interest rates, we recorded a net unrealized non-cash holding gain of € 44.7 million before minority interests upon the marked to market valuation of such derivatives that were outstanding at the end of the current quarter, compared to a net non-cash holding loss of € 69.5 million before minority interests upon the marked to market valuation of our outstanding derivatives in the comparative quarter of 2005.

In the second quarter of 2006, minority interest, representing the two minority shareholders' proportionate interest in the Stendal mill, was € 0.4 million, compared to € 4.9 million in the second quarter of 2005.

We reported net income for the three months ended June 30, 2006 of € 18.4 million, or € 0.56 per basic and € 0.45 per diluted share, which included an aggregate of € 50.8 million unrealized gains on our outstanding derivatives and a foreign exchange gain on our long-term debt. In the second quarter of 2005, we reported a net loss of € 62.2 million, or € 1.88 per basic and diluted share, which reflected the net unrealized non-cash holding losses on our currency and interest rate derivatives of € 69.5 million and the unrealized non-cash foreign exchange loss on our long-term debt of € 9.8 million, partially offset by the non-cash benefit for income taxes of € 244 million, and interest expense related to our Stendal mill of € 14.5 million.

We generated "Operating EBITDA" of € 25.7 million and € 23.1 million in the three months ended June 30 2006 and 2005, respectively. Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of our results for the first half of 2006 for additional information relating to Operating EBITDA.

The following table provides a reconciliation of net income (loss) to income from operations and Operating EBITDA for the periods indicated:

| | Three Months Ended June 30, | |
|---|--------------------------------|-----------------|
| | 2006 | 2005 |
| (in thousands) | | |
| Net income (loss) | € 18,421 | € (62,151) |
| Minority interest | (449) | (4,852) |
| Income taxes (benefit) | 21,807 | (24,447) |
| Interest expense | 23,112 | 22,200 |
| Investment income | (1,267) | (806) |
| Derivative financial instruments, net (gain) loss | (44,690) | 69,451 |
| Foreign exchange (gain) loss on debt | (6,060) | 9,806 |
| Income from operations | 10,874 | 9,201 |
| Add: Depreciation and amortization | 14,868 | 13,896 |
| Operating EBITDA | <u>€ 25,742</u> | <u>€ 23,097</u> |

Liquidity and Capital Resources

The following table is a summary of selected financial information for the periods indicated:

| | As at June 30, 2006 | As at December 31, 2005 |
|--------------------------------|---------------------------|-------------------------------|
| | (in thousands) | |
| Financial Position | | |
| Cash and cash equivalents | € 73,079 | € 83,547 |
| Working capital ⁽¹⁾ | 57,287 | 111,195 |
| Property, plant and equipment | 1,008,319 | 1,024,662 |
| Total assets | 1,370,798 | 1,393,816 |
| Long-term liabilities | 996,383 ⁽²⁾ | 1,104,746 |
| Shareholders' equity | 189,927 | 148,743 |

(1) Does not include approximately € 7.0 million of government grants in 2006, which we expect to receive in 2006, and approximately € 65.9 million of government grants in 2005, all of which has been received, related to the Stendal mill from German federal and state governments.

(2) Includes € 15.6 million outstanding under the revolving credit facilities for the Celgar mill.

At June 30, 2006, our cash and cash equivalents were € 73.1 million, compared to € 83.5 million at December 31, 2005. We also had € 5.9 million of cash restricted to pay current Stendal construction costs payable of € 1.0 million and for debt service.

During the second quarter of 2006, Stendal built up the restricted cash in its debt service account for the Stendal project financing to € 66.5 million by drawing down € 42.0 million under a tranche of the Stendal project financing facility as planned, or the “Stendal Loan Facility”. Approximately € 57.0 million of this restricted cash is a debt service security or reserve equal to approximately one year’s worth of Stendal’s scheduled principal and interest payments under the Stendal Loan facility. As this debt service account secures Stendal’s obligations under the Stendal Loan Facility, it is recorded as a long-term asset.

Our reduction in working capital at June 30, 2006 compared to December 31, 2005 of approximately € 539 million resulted principally from the build-up of the restricted cash in the Stendal debt service account, which is classified as a long-term asset, and the reclassification as current liabilities of certain principal payments on the Stendal Loan Facility that mature within one year.

At June 30, 2006, we qualified for investment grants related to the Stendal mill totaling approximately € 7.0 million from the federal and state governments of Germany, which we expect to receive in 2006. These grants, when received, will be applied to repay the amounts drawn under the current portion of a dedicated tranche of the Stendal Loan Facility. Under our accounting policies, we do not record these grants until they are received. The grants are not reported in our income and reduce the cost basis of the assets purchased when they are received.

As at June 30, 2006, we had not drawn any amount under the € 40.0 million Rosenthal revolving term credit facility and had drawn down approximately € 15.6 million of the C\$40 million Celgar revolving credit facility. At June 30, 2006, we had utilized the entire € 4.7 million available under the credit facilities for our paper operations.

We expect to meet our interest and debt service expenses and the working and maintenance capital requirements for our operations (other than at Stendal) from cash flow from operations, cash on hand and the two revolving working capital facilities for the Rosenthal and Celgar mills.

We expect to meet the capital requirements for the Stendal mill, including working capital and potential losses during ramp up, interest and principal service expenses through cash on hand, cash flow from operations, shareholder advances already made to Stendal, the Stendal Loan Facility (which includes a revolving working capital tranche and a debt service reserve account) and the receipt of government grants.

Operating Activities

Operating activities in the first half of 2006 provided cash of € 1.4 million, compared to using cash of € 5.2 million in the comparative period of 2005. An increase in receivables due primarily to higher sales used cash of € 13.5 million in the first half of 2006, compared to an increase in receivables using cash of € 20.7 million in the comparative period of 2005. A decrease in inventories due primarily to a reduction in raw materials and finished goods at the Stendal mill provided cash of € 10.7 million in the first half of 2006, compared to using cash of € 16.8 million in the comparative period of 2005. A decrease in accounts payable and accrued expenses used cash of € 3.3 million in the first half of 2006, compared to an increase that provided cash of € 41.3 million in the comparative period of 2005.

Working capital is subject to cyclical operating needs, the timing of collections, receivables and government grants and the payment of payables and expenses.

Investing Activities

Investing activities in the six months ended June 30, 2006 used cash of € 56.3 million, compared to the six months ended June 30, 2005 when investing activities used cash of € 119.3 million, of which the acquisition of the Celgar pulp mill comprised € 146.6 million. In the six months ended June 30, 2006, a drawdown under a tranche of the Stendal project financing facility to increase our restricted cash in the Stendal debt service reserve account used cash of € 40.8 million versus a decrease in restricted cash providing cash of € 35.8 million in the comparative period of 2005.

Financing Activities

Financing activities provided cash of € 45.7 million in the six months ended June 30, 2006, compared to the first six months of 2005 when, in connection with the acquisition of the Celgar pulp mill, financing activities, including the issuance of common stock and senior notes, provided cash of € 175.2. In the first half of 2005, we fully repaid the project loan facility relating to the Rosenthal mill of approximately €143.1 million (net of restricted cash) and indebtedness relating to the landfill at the Rosenthal mill of approximately € 7.6 million from the proceeds of such share and senior note offerings.

We have no material commitments to acquire assets or operating businesses. We anticipate that there will be acquisitions of businesses or commitments to projects in the future. To achieve our long-term goals of expanding our asset and earnings base through the acquisition of interests in companies and assets in the pulp and paper and related businesses, and organically through high return capital expenditures at our operating facilities, we will require substantial capital resources. The required necessary resources for such long-term goals will be generated from cash flow from operations, cash on hand, the sale of securities and/or assets, and borrowing against our assets.

Contractual Obligations and Commitments

There were no material changes outside the ordinary course to any of our contractual obligations during the first half of 2006.

Capital Resources

In addition to our revolving credit facilities for the Rosenthal and Celgar mills and the revolving working capital tranche of the Stendal Loan Facility, respectively, we may seek to raise future funding in the debt markets if our indenture relating to our 9.25% senior notes permits, subject to compliance with the indenture. The indenture governing the senior notes provides that, in order for Mercer Inc. and its restricted subsidiaries (as defined in the indenture and which excludes the Stendal mill and our paper operations) to enter into certain types of transactions, including the incurrence of additional indebtedness, the making of restricted payments and the completion of mergers and consolidations (other than, in each case, those specifically permitted by our senior note indenture), we must meet a minimum ratio of Indenture EBITDA to Fixed Charges as defined in the senior note indenture of 2.0 to 1.0 on a pro forma basis for the most recently ended four full fiscal quarters. This ratio is referred to and defined as the Fixed Charge Coverage Ratio in the senior note indenture. As at June 30, 2006, Mercer Inc. and our restricted subsidiaries under the indenture governing the senior notes did not meet the Fixed Charge Coverage Ratio of 2.0 to 1.0 as set out in the senior note indenture.

Stendal Pulp Mill EPC Contract

The Stendal mill was constructed under a € 716.0 million fixed price turn-key EPC contract between Stendal and RWE, as head contractor. The contractor's obligations under the contract are guaranteed by its parent company.

Pursuant to the EPC contract, each department of the mill is to be tested on a stand-alone basis for compliance with its design specifications. Under the EPC contract, RWE warrants conformity to specifications, compliance with permits and laws, suitability for intended use, compliance with performance requirements and against defects in construction for a stipulated period, subject to extension in certain circumstances. The testing and warranty are highly technical and include very detailed design and performance specifications. Much of the prescribed testing, other than testing waived by prior agreement, had been concluded by the quarter ended June 30, 2006 and was unsatisfactory to Stendal. Unless extended, the period under which Stendal can make claims under the warranties in the EPC contract currently expires in September 2006. As is common in large greenfield projects like the Stendal mill, Stendal currently anticipates that it will make a number of claims and seek penalties against the contractor under the EPC contract. Such claims are often highly technical and relate to, among other things, design and performance specifications and reliability, as well as penalties in regards to delays. Currently, we cannot predict with any certainty which or the amount of claims and penalties that Stendal may make against the contractor, the amount, if any, of any recoveries associated therewith or the final determination of such claims whether through further work and retesting by the contractor, legal proceedings, negotiation or other settlement.

Paper Mill Assets

We view our paper mill assets as non-core operations and have been reviewing strategic alternatives therefor. In August 2006, we reorganized and divested our equity interests in certain paper production assets, including our Heidenau paper mill, for aggregate consideration of approximately € 5.0 million of indebtedness and approximately € 5.0 million in cash. We currently continue to operate and review strategic alternatives for our Fährbrücke paper mill.

Foreign Currency

Effective January 1, 2002, we changed our reporting currency from the U.S. dollar to the Euro as a significant majority of our business transactions are originally denominated in Euros. By adopting the Euro, most cumulative foreign currency translation losses were eliminated. However, we hold certain assets and liabilities in U.S. dollars, Swiss francs and in Canadian dollars. Accordingly, our consolidated financial results are subject to foreign currency exchange rate fluctuations.

We translate foreign denominated assets and liabilities into Euros at the rate of exchange on the balance sheet date. Unrealized gains or losses from these translations are recorded in our consolidated statement of comprehensive income and impact on shareholders' equity on the balance sheet but do not affect our net earnings.

In the six months ended June 30, 2006, we reported a net €5.4 million foreign exchange translation gain and, as a result, the cumulative foreign exchange translation gain increased to € 21.1 million at June 30, 2006 from € 15.6 million at December 31, 2005.

Based upon the exchange rate at June 30, 2006, the U.S. dollar decreased by approximately 6% in value against the Euro since June 30, 2005. See “Quantitative and Qualitative Disclosures about Market Risk”.

Results of Operations of the Restricted Group Under Our Senior Note Indenture

The indenture governing our 9.25% senior notes requires that we also provide a discussion in annual and quarterly reports we file with the SEC under Management’s Discussion and Analysis of Financial Condition and Results of Operations of the results of operations and financial condition of Mercer Inc. and our restricted subsidiaries under the indenture, referred to as the “Restricted Group”. As at and during the six months ended June 30, 2006, the Restricted Group was comprised of Mercer Inc., certain holding subsidiaries, Rosenthal and Celgar. During the six months ended June 30, 2005 and as at December 31, 2005, the Restricted Group was comprised of Mercer Inc., certain holding subsidiaries, Rosenthal and the Celgar mill from February 14, 2005, the date of the acquisition of the mill. The Restricted Group excludes our paper operations and our Stendal mill.

The following is a discussion of the results of operations and financial condition of the Restricted Group. For further information regarding the operating results of the Rosenthal and Celgar mills, see Note 5 of our quarterly financial statements included herein. For further information regarding the Restricted Group including, without limitation, a reconciliation to our consolidated results of operations, see Note 9 of our quarterly financial statements included herein.

Restricted Group Results — Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Total revenues for the Restricted Group for the six months ended June 30, 2006 increased to € 169.6 million from € 114.4 million in the comparative period of 2005, primarily because of higher pulp sales from the Celgar mill and higher pulp prices. Pulp sales realizations for the Restricted Group were € 444 per ADMT on average in the six months ended June 30, 2006 and € 427 per ADMT in the comparative period of 2005. The increase in NBSK pulp prices was partially offset by the strength of the Canadian dollar versus the U.S. dollar during the current period.

Costs of sales and general, administrative and other expenses for the Restricted Group in the six months ended June 30, 2006 increased to € 169.3 million from €107.0 million in the comparative period of 2005 primarily as a result of the inclusion of higher sales from our Celgar mill, partially offset by lower production costs at the Rosenthal mill.

During the current period, we took an aggregate of 33 days scheduled maintenance and strategic capital expenditure downtime comprising 20 days at our Rosenthal mill and 13 days at our Celgar mill. During the downtime at our Rosenthal mill, we completed the installation of a new brownstock washer at a cost of approximately €9.7 million, which is expected to further improve pulp quality and lower chemical costs and effluents. The total maintenance costs associated with such shutdowns were approximately € 6.5 million and were expensed as incurred. This negatively impacted our production volumes, costs and operating results. During the comparative period of 2005, the Rosenthal and Celgar mills took approximately 9 days of maintenance and strategic capital expenditure downtime.

In the first half of 2006, we recorded a contribution to income from operations of € 3.7 million through the sale of emission allowances by our Rosenthal pulp mill, compared to € 2.1 million in the same period of 2005.

On average, fiber costs at our Rosenthal pulp mill increased by approximately 14% in the first half of 2006 versus the same period of 2005. This resulted from lower availability because of severe winter conditions in Germany and central Europe, which caused sawmillers and log

harvesters to curtail operations and increased competition for fiber primarily from renewable energy operations. In the first half of 2006, average fiber costs at our Celgar mill decreased by approximately 18% versus the same period of 2005, primarily because of increased regional wood chip availability.

Depreciation and amortization for the Restricted Group increased to € 14.2 million in the current period from € 10.8 million in the comparative period of 2005, primarily as a result of the inclusion of depreciation of the Celgar mill for the full period, partially offset by lower depreciation at our Rosenthal mill.

In the first half of 2006, the Restricted Group reported income from operations of € 0.3 million, compared to € 7.4 million in the first half of 2005, primarily as a result of a higher operating loss at our Celgar mill which more than offset higher operating income from our Rosenthal mill. Interest expense for the Restricted Group in the six months ended June 30, 2006 increased marginally to € 16.4 million from € 16.0 million in the first half of 2005.

In the first half of 2006, the Restricted Group recorded a foreign exchange gain on debt of € 12.2 million, compared to a loss of € 7.5 million in the comparative period of 2005. In the first half of 2005, the Restricted Group reported a non-cash impairment charge of € 1.6 million related to an investment in a venture company.

For the six months ended June 30, 2006, the net loss reported by the Restricted Group narrowed to € 87 million from € 21.7 million in the first half of 2005 as a result of improved operating income of our Rosenthal mill, partially offset by the weaker results of our Celgar mill and scheduled downtime. The overall strength of the Canadian dollar versus the U.S. dollar and 13 days of scheduled maintenance downtime negatively impacted the results of our Celgar mill.

The Restricted Group generated "Operating EBITDA" of € 14.5 million and € 18.2 million in the six months ended June 30, 2006 and 2005, respectively. Operating EBITDA is defined as income (loss) from operations plus depreciation and amortization and non-recurring capital asset impairment charges. Operating EBITDA for the Restricted Group is calculated by adding depreciation and amortization and non-recurring capital asset impairment charges of € nil and € 1.6 million to the income from operations of € 0.3 million and € 7.4 million for the six months ended June 30, 2006 and 2005, respectively.

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of Mercer's results for the six months ended June 30, 2006 for additional information relating to such limitations and Operating EBITDA.

The following table provides a reconciliation of net loss to income from operations and Operating EBITDA for the Restricted Group for the periods indicated:

| | Six Months Ended June 30, | |
|---|------------------------------|---------------------|
| | 2006 | 2005 ⁽¹⁾ |
| | (in thousands) | |
| Restricted Group ⁽²⁾ | | |
| Net loss | € (8,741) | €(21,696) |
| Income taxes | 6,905 | 4,776 |
| Interest expense | 16,442 | 15,985 |
| Investment and other income | (2,119) | (1,297) |
| Derivative financial instruments, net | — | 463 |
| Unrealized foreign exchange (gain) loss on debt | (12,173) | 7,509 |
| Impairment of investments | — | 1,645 |
| (Loss) income from operations | 314 | 7,385 |
| Add: Depreciation and amortization | 14,197 | 10,829 |
| Operating EBITDA | <u>€ 14,511</u> | <u>€ 18,214</u> |

(1) The results of the Celgar pulp mill are from the date of its acquisition on February 14, 2005.

(2) See Note 9 of the financial statements included elsewhere herein for a reconciliation to our consolidated results.

Restricted Group Results — Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Total revenues for the Restricted Group for the three months ended June 30, 2006 increased to € 88.6 million from € 72.7 million in the comparative period of 2005, primarily due to higher sales from our Celgar pulp mill and higher pulp prices. Pulp sales realizations for the Restricted Group were € 459 per ADMT on average in the three months ended June 30, 2006 and € 430 per ADMT in the comparative period of 2005. The increase in NBSK pulp prices was partially offset by the strength of the Canadian dollar versus the U.S. dollar during the current period. In the second quarter of 2006, Mercer Inc. had responsibility for all pulp sales of the Stendal mill and received fees from Stendal ranging from 0.5% to 1.4% of sales.

Costs of sales and general, administrative and other expenses for the Restricted Group in the three months ended June 30, 2006 increased to € 90.3 million from € 67.3 million in the comparative period of 2005, primarily as a result of higher pulp sales from the Celgar mill, partially offset by lower production costs of the Rosenthal mill.

During the current quarter we took an aggregate of 24 days scheduled maintenance and strategic capital expenditure downtime comprising 16 days at our Rosenthal mill and 8 days at our Celgar mill. During the downtime at our Rosenthal mill, we completed the installation of a new brownstock washer at a cost of approximately € 9.7 million, which is expected to further improve pulp quality and lower chemical costs and effluents. The total maintenance costs associated with such shutdowns were approximately € 4.3 million and were expensed in the current quarter. Total volume production at our Rosenthal and Celgar mills was down by approximately 24,000 tonnes or 13% in the current quarter of 2006 compared to the same period of 2005. This negatively impacted our production volumes, costs and operating results. During the same period of 2005, we had approximately 4 days of maintenance and strategic capital expenditure downtime at our Rosenthal and Celgar mills.

In the second quarter of 2006, we recorded a contribution to income from operations of € 1.9 million through the sale of emission allowances by our Rosenthal pulp mill, compared to € 2.1 million in the same period of 2005.

On average, fiber costs at our Rosenthal pulp mill increased by approximately 8% in the second quarter of 2006 versus the same period of 2005. This resulted from lower availability because of severe winter conditions in Germany and central Europe, which caused sawmillers and log harvesters to curtail operations and increased competition for fiber primarily from renewable energy operations. In the second quarter of 2006, average fiber costs at our Celgar mill decreased by approximately 23% versus the same period of 2005 because of increased regional wood chip availability. Subsequent to June 30, 2006, lower chip availability resulting from softer lumber markets and an increase in chip demand from coastal pulp and paper mills is expected to put upward pressure on Celgar's fiber costs in the second half of 2006.

Depreciation and amortization for the Restricted Group increased to € 7.6 million in the current quarter from € 6.7 million in the comparative period of 2005.

In the second quarter of 2006, the Restricted Group reported a loss from operations of € 1.7 million, compared to reported income from operations of € 5.4 million in the second quarter of 2005, primarily as a result of a higher operating loss at our Celgar mill which more than offset higher operating income from our Rosenthal mill.

Interest expense for the Restricted Group in the three months ended June 30, 2006 decreased to € 8.0 million from € 8.3 million in the second quarter of 2005.

In the second quarter of 2006, the Restricted Group recorded a foreign exchange gain on debt of € 6.1 million, compared to a loss of € 9.8 million in the comparative period of 2005. In the second quarter of 2005, the Restricted Group reported a non-cash impairment charge of € 0.5 million related to an investment in a venture company.

For the three months ended June 30, 2006, the net loss reported by the Restricted Group narrowed to € 7.6 million from € 14.3 million in the second quarter of 2005 as a result of improved operating income of our Rosenthal mill, partially offset by the weaker results of our Celgar mill. The overall strength of the Canadian dollar versus the U.S. dollar and 24 days of scheduled maintenance and strategic capital expenditure downtime at our Rosenthal and Celgar pulp mills in the second quarter of 2006 negatively impacted our results.

The Restricted Group generated "Operating EBITDA" of € 5.8 million and € 12.1 million in the three months ended June 30, 2006 and 2005, respectively. Operating EBITDA for the Restricted Group is calculated by adding depreciation and amortization and non-recurring capital asset impairment charges of € nil million and € 0.5 million to the (loss) income from operations of € (1.7) million and € 5.4 million for the three months ended June 30, 2006 and 2005, respectively.

Operating EBITDA has significant limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. See the discussion of Mercer's results for the six months ended June 30, 2006 for additional information relating to such limitations and Operating EBITDA.

The following table provides a reconciliation of net loss to income from operations and Operating EBITDA for the Restricted Group for the periods indicated:

| | Three Months Ended June 30, | |
|---|--------------------------------|-----------------|
| | 2006 | 2005 |
| (in thousands) | | |
| Restricted Group ⁽¹⁾ | | |
| Net loss | € (7,590) | €(14,278) |
| Income taxes | 3,872 | 1,661 |
| Interest expense | 7,979 | 8,314 |
| Investment and other expense (income) | 142 | (970) |
| Derivative financial instruments, net | (79) | 358 |
| Unrealized foreign exchange (gain) loss on debt | (6,060) | 9,806 |
| Impairment of investments | — | 467 |
| (Loss) income from operations | (1,736) | 5,358 |
| Add: Depreciation and amortization | 7,568 | 6,704 |
| Operating EBITDA | <u>€ 5,832</u> | <u>€ 12,062</u> |

(1) See Note 9 of the financial statements included elsewhere herein for a reconciliation to our consolidated results.

Liquidity and Capital Resources of the Restricted Group

The following table is a summary of selected financial information for the Restricted Group for the periods indicated:

| | As at June 30, 2006 | As at December 31, 2005 |
|---|---------------------------|-------------------------------|
| | (in thousands) | |
| Restricted Group Financial Position ⁽¹⁾ | | |
| Cash and cash equivalents | € 37,018 | € 48,790 |
| Working capital | 80,908 | 93,312 |
| Property, plant and equipment | 400,045 | 404,151 |
| Total assets | 602,304 | 625,578 |
| Long-term liabilities | 346,271 | 364,596 |
| Shareholders' equity | 212,182 | 214,115 |

(1) See Note 9 of the financial statements included elsewhere herein for a reconciliation to our consolidated results.

At June 30, 2006, the Restricted Group had cash and cash equivalents of € 37.0 million, compared to €48.8 million at December 31, 2005. At June 30, 2006, the Restricted Group had working capital of € 80.9 million.

We expect the Restricted Group to meet its interest and debt service expenses and meet the working and maintenance capital requirements for its current operations from cash flow from operations, cash on hand and the revolving working capital loan facilities for the Rosenthal and Celgar mills. As at June 30, 2006, we had not drawn any amount under the Rosenthal revolving term credit facility and had drawn down approximately € 15.6 million under the C\$40 million Celgar revolving credit facility.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates are used for, but not limited to, the accounting for doubtful accounts, depreciation and amortization, asset impairments, derivative financial instruments, environmental conservation, asset retirement obligations, pensions and post-retirement benefit obligations, income taxes, and contingencies. Actual results could differ from these estimates.

Our management routinely makes judgments and estimates about the effects of matters that are inherently uncertain. As the number of variables and assumptions affecting the probable future resolution of the uncertainties increase, these judgments become even more subjective and complex. We have identified certain accounting policies that are the most important to the portrayal of our current financial condition and results of operations.

For information about our significant accounting policies, see our annual report on Form 10-K for the year ended December 31, 2005.

Cautionary Statement Regarding Forward-Looking Information

The statements in this report that are not reported financial results or other historical information are “forward-looking statements” within the meaning of the *Private Securities Litigation Reform Act of 1995*, as amended. These statements appear in a number of different places in this report and can be identified by words such as “estimates”, “projects”, “expects”, “intends”, “believes”, “plans”, or their negatives or other comparable words. Also look for discussions of strategy that involve risks and uncertainties. Forward-looking statements include statements regarding the outlook for our future operations, forecasts of future costs and expenditures, the evaluation of market conditions, the outcome of legal proceedings, the adequacy of reserves, or other business plans. You are cautioned that any such forward-looking statements are not guarantees and may involve risks and uncertainties. Our actual results may differ materially from those in the forward-looking statements due to risks facing us or due to actual facts differing from the assumptions underlying our estimates. Some of these risks and assumptions include those set forth in reports and other documents we have filed with or furnished to the SEC, including in our annual report on Form 10-K for the year ended December 31, 2005. We advise you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to us or persons acting on our behalf. Unless required by law, we do not assume any obligation to update forward-looking statements based on unanticipated events or changed expectations. However, you should carefully review the reports and other documents we file from time to time with the SEC.

Cyclical Nature of Business

Revenues

The pulp and paper business is cyclical in nature and markets for our principal products are characterized by periods of supply and demand imbalance, which in turn affects product prices. The markets for pulp and paper are highly competitive and are sensitive to cyclical changes in industry capacity and in the global economy, all of which can have a significant influence on selling prices and our earnings. Demand for pulp and paper products has historically been determined by the level of economic growth and has been closely tied to overall business activity. Although pulp prices have improved recently, we cannot predict the level of economic activity or growth in certain world markets or the impact of war, terrorist activity or other events on our markets and prices for our products.

Commencing in 2005, our German operations became subject to the European Union Emissions Trading Scheme pursuant to which our German mills were granted emission allowances. Emission allowances are granted based upon production volumes and the types of fuels consumed by the manufacturing facilities in Germany. Since then, we have benefited from the sale of emission allowances. However, the market for such sales is relatively new and volatile and we cannot predict the level of any sales thereafter.

Costs

Our production costs are influenced by the availability and cost of raw materials, energy and labor, and our plant efficiencies and productivity. Our main raw material is fiber in the form of wood chips and pulp logs for pulp production, and waste paper and pulp for paper production. Fiber costs are primarily affected by the supply of, and demand for, lumber and pulp, which are both highly cyclical in nature and can vary significantly by location. Recently, fiber demand in Europe has also increased because of a demand from renewable energy projects. Production costs also depend on the total volume of production. Lower operating rates and production efficiencies during periods of cyclically low demand result in higher average production costs and lower margins.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks from changes in interest rates and foreign currency exchange rates, particularly the exchange rate between the U.S. dollar and the Euro and to a lesser extent the Canadian dollar, which may affect our results of operations and financial condition and, consequently, our fair value. We manage these risks through internal risk management policies and, with respect to risks related to changes in exchange rates between the U.S. dollar and the Euro, with the use of derivatives. We use derivatives to reduce or limit our exposure to interest rate and U.S. dollar/Euro currency risks. We may in the future use derivatives to reduce or limit our exposure to fluctuations in pulp prices. We also use derivatives to reduce our potential losses or to augment our potential gains, depending on our management's perception of future economic events and developments. These types of derivatives are generally highly speculative in nature. They are also very volatile as they are highly leveraged given that margin requirements are relatively low in proportion to notional amounts.

Many of our strategies, including the use of derivatives, and the types of derivatives selected by us, are based on historical trading patterns and correlations and our management's expectations of future events. However, these strategies may not be fully effective in all market environments or against all types of risks. Unexpected market developments may affect our risk management strategies during this time, and unanticipated developments could impact our risk management strategies in the future. If any of the variety of instruments and strategies we utilize are not effective, we may incur losses.

All of our derivatives are marked to market at the end of each reporting period, and all unrealized gains and losses are recognized in earnings for a reporting period. We determine market valuations based primarily upon valuations provided by our counterparties.

In the first quarter of 2005, Stendal entered into currency swaps to convert a portion of its indebtedness under the Stendal Loan Facility from Euros into U.S. dollars and certain currency forwards. In April 2005, Stendal entered into a currency swap to convert the balance of its long-term indebtedness under the Stendal Loan Facility from Euros into U.S. dollars. During the first half of 2006, we recorded a net unrealized non-cash holding gain of € 90.7 million before minority interests upon the marked to market valuation of such derivatives compared to a net non-cash holding loss of € 73.0 million before minority interests upon the marked to market valuation of our outstanding derivatives in the first half of 2005. In the first half of 2006, we had a realized loss of € 5.2 million on certain currency forwards which had matured, compared to a realized loss of € 0.3 million on derivative instruments in the first half of 2005

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. Our management, with the participation of our Principal Executive Officer and Principal Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this report. Based on such evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission’s rules and forms and to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to management, including its Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

It should be noted that any system of controls is based in part upon certain assumptions designed to obtain reasonable (and not absolute) assurance as to its effectiveness, and there can be no assurance that any design will succeed in achieving its stated goals.

Changes in Internal Controls. There have been no significant changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In October 2005, our wholly owned subsidiary, Zellstoff Celgar Limited, received a re-assessment for real property transfer tax payable in British Columbia, Canada, in the amount of approximately € 3.5 million in connection with the transfer of the land where the Celgar mill is situated. The Company is contesting the assessment and the amount, if any, that may be payable in connection therewith is not yet determinable. Any additional amount paid in connection with the re-assessment will increase the cost basis of the assets acquired.

We are subject to routine litigation incidental to our business. We do not believe that the outcome of such litigation will have a material adverse effect on our business or financial condition.

ITEM 1A. RISK FACTORS

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS

We held our annual meeting of shareholders on June 12, 2006. At the meeting, our six directors were re-elected to our board of directors and the selection of Deloitte & Touche LLP as our independent auditors was ratified.

The votes cast by shareholders at the meeting as to the election of directors were as follows:

| | <u>Votes For</u> | <u>Votes Withheld</u> | <u>Abstentions and Broker Non-Votes</u> |
|----------------------|------------------|-----------------------|---|
| Jimmy S.H. Lee | 16,840,127 | 129,064 | — |
| Kenneth A. Shields | 16,843,181 | 126,010 | — |
| William D. McCartney | 16,841,981 | 121,010 | — |
| Graeme A. Witts | 16,841,981 | 127,210 | — |
| Eric Lauritzen | 16,843,171 | 126,020 | — |
| Guy W. Adams | 16,841,981 | 127,210 | — |

ITEM 6. EXHIBITS

| Exhibit No. | Description |
|--------------------|--|
| 31.1 | Section 302 Certification of Chief Executive Officer |
| 31.2 | Section 302 Certification of Chief Financial Officer |
| 32.1* | Section 906 Certification of Chief Executive Officer |
| 32.2* | Section 906 Certification of Chief Financial Officer |

* In accordance with Release 33-8212 of the Commission, these Certifications: (i) are “furnished” to the Commission and are not “filed” for the purposes of liability under the Securities Exchange Act of 1934, as amended; and (ii) are not to be subject to automatic incorporation by reference into any of the Company’s registration statements filed under the Securities Act of 1933, as amended for the purposes of liability thereunder or any offering memorandum, unless the Company specifically incorporates them by reference therein.

SIGNATURES

Pursuant to the requirements of the *Securities Exchange Act of 1934*, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MERCER INTERNATIONAL INC.

By: /s/ David M. Gandossi
David M. Gandossi
Secretary and Chief Financial Officer

Date: August 8, 2006

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EXHIBIT 31.1

CERTIFICATION OF PERIODIC REPORT

I, Jimmy S.H. Lee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mercer International Inc. (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others with those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: August 8, 2006

/s/ Jimmy S.H. Lee

Jimmy S.H. Lee

Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF PERIODIC REPORT

I, David M. Gandossi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mercer International Inc. (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others with those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: August 8, 2006

/s/ David M. Gandossi
David M. Gandossi
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION OF PERIODIC REPORT

I, Jimmy S.H. Lee, Chief Executive Officer of Mercer International Inc. (the "Company"), certify pursuant to Section 906 of the *Sarbanes-Oxley Act of 2002*, 18 U.S.C. Section 1350, that:

- (1) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended June 30, 2006 (the "Report") fully complies with the requirements of Section 13(a) of the *Securities Exchange Act of 1934* (15 U.S.C. 78m or 78o(d)); and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 8, 2006

/s/ Jimmy S.H. Lee

Jimmy S.H. Lee
Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to Mercer International Inc. and will be retained by Mercer International Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION OF PERIODIC REPORT

I, David M. Gandossi, Chief Financial Officer of Mercer International Inc. (the "Company"), certify pursuant to Section 906 of the *Sarbanes-Oxley Act of 2002*, 18 U.S.C. Section 1350, that:

- (1) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended June 30, 2006 (the "Report") fully complies with the requirements of Section 13(a) of the *Securities Exchange Act of 1934* (15 U.S.C. 78m or 78o(d)); and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 8, 2006

/s/ David M. Gandossi

David M. Gandossi
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Mercer International Inc. and will be retained by Mercer International Inc. and furnished to the Securities and Exchange Commission or its staff upon request.